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C O N F I D E N T I A L SECTION 01 OF 02 RANGOON 001164

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TAGS: EFIN ECON BM
SUBJECT: BURMA'S PRIVATE BANKS FACE FINAL ORDEAL TO RESUME OPERATIONS

REF: RANGOON 846 AND PREVIOUS

Classified By: COM CARMEN MARTINEZ FOR REASONS 1.5 (B,D)

¶1. (C) Summary: The Burmese government seems poised to allow private banks to resume operations if they meet seven financial conditions. The government has severely limited private banking operations since a run and subsequent crash in February. Even without the authorities' blessing, many smaller private banks have already re-opened for business. Sadly, we don't see the government's "resolution" of this eight-month-old crisis including the reforms necessary to rebuild a discredited, eviscerated private banking system. End summary.

Rule of Sevens

¶2. (C) According to banking sources, the GOB has made a decision to "resolve" the banking crisis in October. Though nothing has been released formally, apparently the Finance Ministry has informed private bankers via the Bank Management Committee -- the committee formed to ride herd on disgraced private bankers following the private banking system's collapse in February.

¶3. (C) Details are still sketchy, but according to the "resolution" plan, as of October 1 private banks will be expected to meet seven conditions. Banks that do not meet all seven will not be allowed to re-open, though there is no mention of how the government intends to dispose of these delinquents.

-- (1) Deposits cannot exceed seven times paid-in capital.
-- (2) Total loans can be no more than 70 percent of total deposits.
-- (3) As announced in June, all "call deposit" accounts (popular "hot money" accounts that offered an annual 4-10 percent interest rate, compounded daily, with no restrictions on withdrawals) must be closed.
-- (4) All Central Bank of Myanmar credit lines must be repaid. According to one banker, most of the banks, which took only minimal credit when the crisis broke, have paid off their debt. However, banks with larger outstanding debt -- such as Asia Wealth Bank (the country's largest), which borrowed 15 billion kyat (about $15 million) -- are in more difficult straits.
-- (5) All Central Bank loans made against banks' government bonds must be repaid.
-- (6) Only government bonds will be considered as paid-in capital. Currently government bonds pay 8.5 percent for 3 years or 9 percent for 5 years while inflation is running 30-40 percent thus far in 2003.
-- (7) Private banks must bring all their accounts into line with pre-existing, but largely ignored, bank management requirements. These include IMF-recommended 5-10 percent reserve requirement (depending on the type of deposit), 20 percent liquidity requirement, and 10 percent capital adequacy ratio.

¶4. (C) At this time, banking sector pundits are predicting that among the largest (by deposits) pre-crash banks, KBZ Bank (run by a close associate of Vice Senior General Maung Aye), Myanmar Mayflower Bank (capitalized largely by ethnic Wa businessmen), and Myanmar Overseas Bank will clear the hurdle -- or be allowed over the hurdle for political reasons. Asia Wealth Bank and Yoma Bank, by far the two largest banks, and the two banks accused of the worst banking practices, are not expected to make the cut and will supposedly be reassessed at year's end.

Throw Back the Little Ones

¶5. (C) On a positive note, officials from some of the fourteen smaller private banks tell us that most of their institutions have already passed the seven tests, and have not been stopped from resuming normal operations -- though they have not received official clearance to do so. However, this will do little to assist the economy or return money to the private banking system. These banks have very small capital bases and loan portfolios, few depositors, few

branches, and are generally in place to serve niche markets. Also, bankers concur with our assumption that most average Burmese will eschew the private banks, large and small, for years to come regardless of the government's certifications.

Haven't We Learned Anything?

¶6. (C) We had hoped that the government would learn some lessons from this eight-month-old crisis and address fundamental flaws that helped spark and fuel the debacle. The needs were clear: punish rogue bankers, rebuild consumer confidence, create an independent Central Bank and task it to improve oversight of lending practices, apply and enforce reasonable financial standards, and relax some of the burdensome regulations -- such as capping deposit and lending rates well below inflation -- that encouraged cowboy banking in order to turn a profit. Though some of the GOB's new conditions are sound, none of these crucial issues was adequately addressed. The GOB has kept its onerous pre-crash policies intact and imposed broad new standards. Adding a low deposit ceiling and lending limitations to interest rate caps will make turning a profit nearly impossible. The government has also made no specific commitment to independent oversight of lending -- other than threats of more frequent visits by military intelligence to suspect borrowers.

¶7. (C) Certainly some businesspeople will bring their deposits and other business back to private banks when and if they emerge "rehabilitated." However, it is unclear how the government expects private banks to win back the majority of their suspicious customers and otherwise operate in this new, more restrictive environment. Perhaps it does not. There have long been rumors that the GOB's top leadership disliked the private banks because they were "disruptive forces" and controlled significant cash reserves. True or not, in this atmosphere we don't see the private banking sector being able to return even to its relatively small pre-crash role in the Burmese economy.
Martinez